UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re	Chapter 9
CITY OF DETROIT, MICHIGAN,	Case No. 13-53846
Debtor.	Hon. Steven W. Rhodes
CITY OF DETROIT, MICHIGAN,	Chapter 9
Plaintiff,	Adversary Proceeding No. 14-04112
vs.	Hon. Steven W. Rhodes
DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION, DETROIT POLICE AND FIRE RETIREMENT SYSTEM SERVICE CORPORATION, DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2005, and DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2006,	
Defendants.	

MEMORANDUM OF LAW IN RESPONSE TO
SERVICE CORPORATIONS' MOTION TO DISMISS

I. INTRODUCTION

The Service Corporations raise a number of disparate arguments that, they claim, warrant dismissal of the City's Complaint. They contend that the City has failed to allege a case or controversy, thereby depriving this Court of jurisdiction; that by suing the Service Corporations, the City is impermissibly suing itself; and that the City's claims for relief fail if the Service Corporations are found to have an independent existence. As a last-ditch effort, the Service Corporations make the groundless accusation that the City has intentionally filed a collusive lawsuit.

None of these arguments holds water. Contrary to the Service Corporations' suggestion, standing is a matter of the Court's jurisdiction over the action as a whole, not individual parties. Because it is clear that an actual "case or controversy" exists between the City and the Funding Trusts, whether the Service Corporations' interests are adverse to the City's is not a basis for dismissing the suit against them. In any event, the Service Corporations' argument that they are not adverse to the City ignores the fact that they are the counterparties to the contracts that the City has asked to the Court to rule are void and unenforceable. Similarly, their argument that the City is suing itself ignores the fact that – at least nominally – the Service Corporations are separate legal entities from the City.

Moreover, the Service Corporations' suggestion that the City's Complaint stands or falls on whether the Service Corporations have an independent existence demonstrates their misunderstanding of the relief sought in the Complaint. This is not an action for a declaratory judgment that the Service Corporations are shams, or instrumentalities, or alter egos of the City. It is an action for a declaratory judgment that the Service Contracts entered into by the City and the Service Corporations are void and unenforceable because they violate applicable law – something that the City has more than adequately pled.

Finally, the Service Corporations' accusation that the City has knowingly brought a collusive action before this Court is groundless. The Service Corporations know full well that, far from acting collusively, the City has gone out of its way to ensure that the Service Corporations have had every opportunity to participate fully and independently in this proceeding and to oppose the relief sought by the City – as indeed they have done. For the Service Corporations to suggest that the City has acted otherwise is flatly untrue.

II. STANDARD OF REVIEW

In deciding a motion to dismiss under Fed. R. Civ. P. 12(b)(1) and (6), incorporated into bankruptcy adversary proceedings by Fed. R. Bankr. P. 7012(b), a court must construe the complaint in the light most favorable to the non-moving party, accept all factual allegations as true, and make reasonable inferences in favor

of the non-moving party. *Kostrzewa v. City of Troy* , 247 F.3d 633, 638 (6th Cir. 2001) (addressing Rule 12(b)(6)); *Baldwin v. Univ. of Pittsburgh Med. Ctr.*, 636 F.3d 69, 73-74 (3d Cir. 2011) (explaining that the standard of review under Rules 12(b)(1) and 12(b)(6) "is the same: we accept as true plaintiffs' material allegations, and construe the complaint in the light most favorable to them.") (internal quotation marks and citation omitted); *see also Davis v. Malatinsky*, 2013 U.S. Dist. LEXIS 161720, *5 (E.D. Mich. Oct. 11, 2013) ("A motion to dismiss under Federal Rule of Civil Procedure 12(b)(1) challenges the court's subject matter jurisdiction by attacking the claim on its face, in which case all factual allegations of the Plaintiff must be considered as true. . . .").

Under the Supreme Court's much-cited decisions in *Twombly* and *Iqbal*, factual allegations in a complaint need only be enough to raise a right to relief above the speculative level, on the assumption that all the allegations in the complaint are true. *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007); *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009). The Sixth Circuit has noted that the *Twombly/Iqbal* decisions do not alter the simple requirement that plaintiffs must plead only the basic elements of a claim, nor do they displace the general rule that courts construe all reasonable inferences, including those related to a plaintiff's legal theory, in favor of the claimants. *Hebron v. Shelby County Government*, 2010 WL 5376869, *2 (6th Cir. 2010).

Based on the facts alleged in the Complaint and reasonable inferences that may be drawn from them, the City's Complaint against the Service Corporations easily surpasses the bar set by Rules 12(b)(1) and (6) and applicable case law.

III. ARGUMENT

A. A Case and Controversy Exists Regarding the Validity of the Service Contracts

The Service Corporations argue that the City's Complaint falls short of the "case and controversy" requirements of Article III of the Constitution and the Declaratory Judgment Act. The Service Corporations assert that "there are no true adverse parties here" and that "the City has no actual opponent and no party with an incentive to act as its adversary and argue opposing positions." Motion Br. at 5, 12. These arguments are both legally and factually unsound for several reasons.

1. Subject Matter Jurisdiction Is Not A Basis For Dismissing Individual Parties From An Action

The Service Corporations' argument fails for the simple reason that Article III standing, and the "case or controversy" requirement to which it gives effect, are matters of the Court's subject matter jurisdiction over the *action*, not its personal jurisdiction over individual *parties*. Indeed, it is black letter law that "the presence of one party with standing is sufficient to satisfy Article III's case or controversy requirement." *Rumsfeld v. Forum for Academic & Institutional Rights,*

Inc., 547 U.S. 47, 52 (2006); *see also Bowsher v. Synar*, 478 U.S. 714, 721 (1986) (declining to consider the standing of other parties where one party had standing); *Chabad of S. Ohio & Congregation Lubavitch v. City of Cincinnati*, 363 F.3d 427, 432 n.1 (6th Cir. 2004) (same).

Similarly, where there is a case or controversy between the plaintiff and one defendant, jurisdiction over the action exists regardless of whether the plaintiff would have standing to maintain an action against other defendants in isolation. *See, e.g.*, *Duke Power Co. v. Carolina Envtl. Study Group*, 438 U.S. 59, 72-81 & n.16 (1978) (finding that the plaintiff had standing to maintain the suit regardless of whether one of the defendants was a proper party). Simply put, an asserted lack of subject matter jurisdiction may be a basis for dismissing the entire action, but it is not grounds for dismissing individual parties from an action over which the court clearly has jurisdiction.

The Service Corporations do not—and cannot seriously—maintain that the City is not adverse to the Funding Trusts and does not have standing to maintain this action against them. This is sufficient to establish the Court's subject matter jurisdiction over the action. As a result, the Service Corporations' motion to dismiss fails at the outset and should be denied.

2. The Service Corporations Are Adverse To The City

Aside from the fact that the Service Corporations' motion has no legal basis, the Service Corporations are also factually incorrect that their interests are not adverse to the City. Rather, the Service Corporations are the counterparties to Service Contracts that are, until demonstrated otherwise, presumptively valid. *See, e.g., Landscape Forms v. Quinlan*, 2012 Mich. App. LEXIS 2163 (Mich. Ct. App. Oct. 25, 2012) (stating that "contracts are generally presumed to be valid and proper"). The City is asking the Court to declare its contracts with the Service Corporations void. Doing so places the counterparties in an inherently adversarial posture.

More to the point, the Service Corporations themselves have actively taken a position that is antagonistic to the City. The Service Corporations argue that no case or controversy exists "when the parties desire precisely the same result." Motion Br. at 8 (citation omitted). If that were the case here, the Service Corporations would not have sought to vacate the default entered against them in this case, much less moved to dismiss the Complaint. If there were truly no case or controversy between the City and the Service Corporations as to the validity of the Service Contracts, the Service Corporations at most would have moved for realignment of the parties and joined the City as a plaintiff. The fact that they did

not, and instead have chosen to fight the Complaint, demonstrates the very case and controversy whose existence they attempt to deny.

The Service Corporations' argument that the City is merely "suing itself," (Motion Br. at 6) confuses economic independence with legal independence. Countless companies have separately-incorporated subsidiaries[1] and – as legally separate entities – parents and subsidiaries could if they wished sue one another. Such lawsuits are rare, since a parent corporation and its subsidiary ordinarily have identical economic interests and, therefore, no reason to sue one another. However, the fact remains that such lawsuits are possible and, in fact, frequently occur in the context of derivative litigation, where a shareholder may bring suit in the name of a subsidiary against a parent corporation for breaches of fiduciary duty or other causes. *See, e.g., Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971) (stockholder of a subsidiary corporation brought a derivative action against the parent corporation for an accounting of excessive dividends and a breach of contract between two subsidiaries); *In re Student Loan Corp. Derivative Litig*., 2002 Del. Ch. LEXIS 7 (Del. Ch. Jan. 8, 2002) (shareholders of subsidiary

[1] The legal distinction between the City and the Service Corporations is even greater than that between a parent and its subsidiaries since the Service Corporations are organized as non-stock corporations and thus are not "owned" by the City. *See* Articles of Incorporation, *available at* http://www.dleg.state.mi.us/bcs_corp/image.asp?FILE_TYPE=ELF&FILE_NAME=D200505\2005122\E0151741.TIF.

corporation brought a derivative action against the parent corporation and its directors).

While the City has alleged and believes it is true that the Service Corporations are mere shell entities, they are – until found to be otherwise – legally distinct corporations from the City. Indeed, the very fact that the Service Corporations have seen fit to engage separate counsel, dispute the allegations of the complaint and file a motion against the City is evidence of their legal independence. And, tellingly, the Service Corporations nowhere actually take the position that they are one and the same as the City itself.[2]

The Service Corporations argue that "[o]ne may not sue himself any more than he may contract with himself." Motion Br. at 6. However, this argument assumes its conclusion: the point is that the City *did* purport to contract with the Service Corporations, and as a result now needs a judicial declaration as to its obligations *vel non* under those contracts.

The cases cited by the Service Corporations are inapposite because each involves an instance where a *single* person or entity sought to participate in a

[2] The Service Corporations easily could have done so, either by not taking steps to erase their default in answering the Complaint or by filing an answer admitting the Complaint's material allegations. Had that occurred, perhaps the Service Corporations would have a point that the City was suing itself; however, it also would be moot since, once the City's claims against the Service Corporations were reduced to judgment, the City would no longer be suing the Service Corporations at all.

lawsuit as both plaintiff and defendant. *See Harrison v. Ford Motor Co.*, 370 Mich. 683 (Mich. 1963) (insurer defending worker's compensation lawsuit could not intervene in the same action as plaintiff); *Allen v. Evans*, 7 Ariz. 354 (Ariz. 1901) (administrator of estate not permitted to sue himself in his representative capacity); *Globe & Rutgers Fire Ins. Co. v. Hines*, 273 F. 774 (2d Cir. 1921) (Director General of Railroads could not act on behalf of both plaintiff and defendant when vehicles from two railroads under his control collided). Here, by contrast, the City and the Service Corporations are legally distinct entities.

In addition, the Michigan Supreme Court in *Harrison* identified the issue underlying the prohibition against suing oneself as the concern that "a full and fair examination of the merits of the case cannot be had when 1 person controls counsel for both sides." *Id.* at 688. That issue does not arise here. The Service Corporations have not alleged, nor could they, that the City controls their counsel. In fact, if it did, the City would have instructed counsel to not file this motion. Regardless of the legal relationship between the City and the Service Corporations, the two sides are represented by separate, independent counsel, enabling a full airing of the merits of the case.

3. The Service Corporations Are Necessary Parties In This Action

In any event, because the Service Corporations are the only parties with which the City directly contracted, the City believes that they are necessary

parties in this action. *See* Fed. R. Civ. P. 19(a). To the extent the Service Corporations believe there is no case or controversy between them and the City because they "desire precisely the same result," Motion Br. at 8, the proper remedy would be for the Service Corporations to be realigned as plaintiffs or designated as nominal defendants. In either case, no grounds exist for dismissing the Service Corporations from the action and, indeed, doing so could jeopardize the Court's ability to "accord complete relief" to the City. Fed. R. Civ. P. 19(a)(A).

B. The City's Claims for Relief Do Not Depend Upon a Finding that the Service Corporations Are Shams

The Service Corporations assert that "[s]hould the Service Corporations be found to have a truly independent existence, then the City's claims for relief fail." Motion Br. at 6. As an initial matter, this is not a proper argument at this stage. A motion to dismiss tests the legal sufficiency of the pleadings, and the mere possibility that the City might not ultimately prevail on some of its factual allegations is not a basis for dismissal. *Szabo v. Bridgeport Machs., Inc*., 249 F.3d 672 (7th Cir. 2001) ("The reason why judges accept a complaint's factual allegations when ruling on motions to dismiss under Rule 12(b)(6) is that a motion to dismiss tests the legal sufficiency of a pleading. Its factual sufficiency will be tested later--by a motion for summary judgment under Rule 56, and if necessary by trial."); *Hand v. ABN AMRO Mortg. Group, Inc*., 2013 U.S. Dist. LEXIS 171692 (S.D. Ga. Dec. 5, 2013) ("A motion for judgment on the pleadings, like a motion to

dismiss, tests the legal sufficiency of the complaint, not whether the plaintiff will ultimately prevail on the merits.")

Equally important, the Service Corporations' statement betrays their fundamental misunderstanding of the relief sought by the City in this adversary proceeding. The City has not asked the Court to find that the Service Corporations are shams. The City has asked the Court to find that the City's obligations to make payments on account of the COPs under the Service Contracts are void. And the City has clearly stated a claim for a declaratory judgment that the Service Contracts are void irrespective of the status of the Service Corporations themselves.

Under Michigan law, a municipality can incur contractual obligations for future services that do not constitute "indebtedness." This is so because, under a true future services contract, no payment obligation arises until the services are rendered. Thus, the payments by a municipality under a future services contract are payments of current expenses rather than satisfaction of pre-existing indebtedness. In such cases, the basis for finding that the obligations incurred do not constitute indebtedness is that ongoing future services are provided. *See, e.g., Walinske v. Detroit-Wayne Joint Bldg. Auth.*, 39 N.W.2d 73, 77 (Mich. 1949); *Drain Commissioner of Oakland County v. City of Royal Oak*, 10 N.W.2d 435 (Mich.

1943); *Ludington Water-Supply Co. v. City of Ludington*, 78 N.W. 558 (Mich. 1899).

The City has alleged, and believes it is true, that the Service Corporations are mere shells and alter egos of the City itself. This fact is significant to the extent that it demonstrates that even if the Service Corporations had wanted to do so, they had no means to provide ongoing future services to the City under the Service Contracts. However, the City has not asked the Court to determine whether the Service Corporations are shams, and the Court need not decide that issue in order to find that the Service Contracts are void *ab initio*.

The dispositive fact, instead, is that the Service Contracts simply did not obligate the Service Corporations to provide future services in the years in which the City was to make scheduled payments thereunder. Because the Service Contracts were not structured to provide the City with future services, they fail to meet the fundamental requirement of future services contracts. Instead, the obligations they imposed were those of indebtedness, in violation of the City's debt limit. This result is due to the structure of the Service Contracts themselves, and would be the same even if the counterparties under the Service Contracts were not the Service Corporations but genuine third parties.

C. The City Has Not Colluded with the Service Corporations

Finally, the Service Corporations accuse the City of deliberately filing a collusive action. This is a serious charge: the Supreme Court has found that collusive lawsuits are "highly reprehensible" and constitute punishable contempt of court. *Hatfield v. King*, 184 U.S. 162, 165-166 (1902); *see also Nelson v. Jacobsen*, 669 P.2d 1207 (Utah 1983) ("[A] plaintiff who institutes a groundless or collusive suit is subject to a suit or counterclaim for abuse of process or malicious prosecution.") (citing W. Prosser, Handbook of the Law of Torts §§ 120, 121 (4th ed. 1971)). The Service Corporations' charges are particularly troubling because, if this were a collusive action, the City would have to be colluding *with the Service Corporations*. Thus, the Service Corporations and their counsel know firsthand that the collusion they allege has never taken place.

Leaving aside the sheer illogic of the Service Corporations' not only accusing the City but – in effect – accusing *themselves* of collusion, there is not a shred of evidence of any such collusion. To the contrary, the record shows just the opposite. After the Service Corporations failed timely to answer the Complaint, the clerk of the court entered a default against them. *See* Docket No. 8. If the City and the Service Corporations were "in fact working together the achieve the same result," as the Service Corporations suggest (Motion Br. at 9), the City would

simply have moved for judgment on the default, and the Service Corporations would have acquiesced.

Instead, as the Service Corporations are well aware, the City readily stipulated to vacate that default and agreed to give the Service Corporations additional time to respond to the Complaint. And the response that ultimately was filed by the Service Corporations was not an answer to the Complaint admitting the truth of the City's allegations, but rather the instant Motion to Dismiss.

Accordingly, the Service Corporations' frivolous allegations of collusion should be disregarded by the Court.

IV. CONCLUSION

For the foregoing reasons, the City respectfully requests that the Court deny the Service Corporations' Motion to Dismiss and grant such further relief as the Court deems appropriate.

Dated: April 28, 2014

Respectfully submitted,

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ATTORNEYS FOR THE CITY OF DETROIT

CERTIFICATE OF SERVICE

I hereby certify that on April 28, 2014, I caused the foregoing *Memorandum of Law in Response to Service Corporations' Motion to Dismiss* to be filed and served via the Court's electronic case filing and noticing system to all registered users that have appeared in this Adversary Proceeding.

Dated: April 28, 2014

/s/ Deborah Kovsky-Apap
Deborah Kovsky-Apap (P68258)